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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1931

No. 575

NORTH AMERICAN OIL CONSOLIDATED
(a corporation),
Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,
Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit and Brief in Support Thereof.

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Subject Index for Petition for Writ of Certiorari

	Pages
Parties	2
Nature of proceedings	2- 4
Summary of matter involved	4- 9
Importance of question presented and reasons relied on for the allowance of the writ	9-12
Prayer	12
Signature of counsel	12

Table of Cases Cited in Petition for Writ of Certiorari

	Pages
Burnet, David, Commissioner of Internal Revenue, v. North American Oil Consolidated, 50 F. (2d) 752	2, 9, 10
Burnet v. Sanford & Brooks Co., 282 U. S. 359	11
U. S. v. Midwest Oil Co., 236 U. S. 459	5
U. S. v. North American Oil Consolidated, et al. (C. C. A. 9), 242 Fed. 723, 264 Fed. 336	5, 6, 10, 11, 12

Table of Statutes Cited in Petition for Writ of Certiorari

	Page
Judicial Code, subdivisions (a) and (c) of sec. 240, amended, U. S. C. A. title 28, sec. 347; 26 Stat. 828, c. 517, sec. 6; 36 Stat. 1157, c. 231, sec. 240; 43 Stat. 938, c. 229, sec. 1	3
Revenue Act of 1916, secs. 10, 13, 13(c), 13(d); 39 Stat. 756, 771	4
Revenue Act of 1917, secs. 4, 201, 1206; 40 Stat. 300, c. 63	4

Subject Index for Brief

	Pages
Jurisdiction	14
(1) Title of case and court	13, 14
(2) Date of decision	14
(3) Opinion Circuit Court of Appeals reported in 50 F. (2d) 752	14
(4) Jurisdiction of this court invoked under sec. 240, Judicial Code, 28 U. S. C. A. sec. 347	14
Statement of the case	14
Summary of argument	15
Argument:	
Point One: The impounded funds should have been reported by the receiver for taxation in 1916	15-26
Point Two: If, however, the impounded funds should not have been reported by the receiver for taxation in 1916, they were taxable to the petitioner company in that year because they constituted accrued income of that company for that year	26-30
Point Three: But if the impounded funds should not have been reported as income in 1916 by either the receiver or the petitioner company, then they should not have been reported at all prior to the year 1922, which was the year in which the litigation was finally terminated in favor of the petitioner company	31-35
Conclusion	35

Table of Cases Cited in Petitioner's Brief

	Pages
Appeal of Cincinnati, Findlay & Ft. Wayne Ry. Co., 5 B. T. A. 108	29
Appeal of Walter Cravens, 3 B. T. A. 282	29
Appeal of General Lead Batteries Co., 2 B. T. A. at p. 395	28
Appeal of S. W. Harris, 2 B. T. A. 933	29
Appeal of Illinois Terminal Co., 5 B. T. A. 15	29
Appeal of Mead Construction Co., 3 B. T. A. 438	29
Appeal of New Orleans, Texas & Mexico Ry. Co., 6 B. T. A. 436	29
Burnet v. North American Oil Consolidated, 50 F. (2d) 752	14, 20
Burnet v. Sanford & Brooks Co., 282 U. S. 359	32, 34, 35
Consolidated Tea Co. v. Bowers (D. C. N. Y.) 19 F. (2d) 382	28, 31, 32, 33
Farmers Nat'l Bank of Rome v. Commissioner, 6 B. T. A. 1036	33
Ferguson v. Forstmann, 25 F. (2d) 47, affirming 17 F. (2d) 659	21, 26
Jewell v. Commissioner, 6 B. T. A. 1040	33
Lehigh & Hudson River Ry. v. Commissioner, 13 B. T. A. 1154, affirmed C. C. A. in 36 F. (2d) 719, as modified by 38 F. (2d) 1015; certiorari denied May 5, 1930	33
United States v. North American Oil Consolidated, 242 Fed. 723; 264 Fed. 336	29, 30
Virginia Carolina Sec. Corpn. v. Commissioner, 6 B. T. A. 84	29

Table of Statutes Cited in Petitioner's Brief

	Pages
Judicial Code, sec. 240; U. S. C. A. title 28, sec. 347	14
Regulations 33, Articles 26, 209	17, 18
Regulations 45, Articles 424, 622	19, 20
Revenue Act of 1916, secs. 8(c), 10, 13(a), 13(c); 39 Stat. 756	15, 16, 18, 19, 26
Revenue Act of 1917, secs. 4, 10(a); 40 Stat. 300	16, 17
Revenue Act of 1918, secs. 225, 239	18, 19, 20

Index to Appendix

	Pages	
Appendix A—Pertinent parts of Revenue Act of 1917	17	i
Appendix B—Section 225, Revenue Act of 1918	18	ii
Appendix C—Section 8(c), Revenue Act of 1916	19	iii
Appendix D—Section 239, Revenue Act of 1918	19	iv
Appendix E—Regulations 45, Articles 424, 622	19	v

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No.

NORTH AMERICAN OIL CONSOLIDATED
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DAVID BURNET, Commissioner of Internal Revenue,
Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit

To the Honorable Charles Evans Hughes, Chief Justice of the Supreme Court of the United States, and to the Associate Justices of the Supreme Court of the United States:

The petition of North American Oil Consolidated, a corporation, for a writ of certiorari directed to the

United States Circuit Court of Appeals for the Ninth Circuit, respectfully shows:

Petitioner, North American Oil Consolidated, a corporation, was the respondent before both the United States Board of Tax Appeals (Docket Nos. 8714 and 16,107) and the United States Circuit Court of Appeals for the Ninth Circuit, the Commissioner of Internal Revenue having been the petitioner before both tribunals. In this petition, and in the brief which follows, the North American Oil Consolidated will be referred to as "Petitioner" or "Petitioner Company," and the Commissioner of Internal Revenue as "Respondent" or "Respondent Commissioner."

NATURE OF PROCEEDINGS.

1. This proceeding is brought and this petition is filed to review the decision of the United States Circuit Court of Appeals for the Ninth Circuit in the case of David Burnet, Commissioner of Internal Revenue, Petitioner, v. North American Oil Consolidated, a corporation, Respondent, which was filed and entered on ~~June~~ September 15, 1931 (R. ~~182-183~~ 184) and is reported in 50 F. (2d) at page 752. ~~A copy of that opinion will be found also in the printed transcript of record at pages 184-198.~~ In accordance with Rule 29 of the said Circuit Court of Appeals, a petition for rehearing was presented by the Petitioner herein on July 15, 1931 (R. 194) and thereafter, on September 15, 1931 (R. 203), the said Court filed an amended opinion and an order directing the modification of its original opinion and denying the said petition for rehearing.

(R. 194.) The ~~amended~~ opinion of the said Court will be found at pages ~~194-203~~ 184-196 of the printed transcript of record herein.

2. The jurisdiction of this Court is invoked under subdivisions (a) and (c) of Section 240, amended, of the Judicial Code (U. S. C. A. title 28, sec. 347; Mar. 3, 1891, c. 517, sec. 6, 26 Stat. 828; Mar. 3, 1911, c. 231, sec. 240, 36 Stat. 1157; Feb. 13, 1925, c. 229, sec. 1, 43 Stat. 938), which read as follows:

> **"Certiorari to circuit courts of appeals and Court of Appeals of District of Columbia; appeal or writ of error to Supreme Court from circuit courts of appeals in certain cases; other reviews not allowed.** (a) In any case, civil or criminal, in a circuit court of appeals, or in the Court of Appeals of the District of Columbia, it shall be competent for the Supreme Court of the United States, upon the petition of any party thereto, whether Government or other litigant, to require by certiorari, either before or after a judgment or decree by such lower court, that the cause be certified to the Supreme Court for determination by it with the same power and authority, and with like effect, as if the cause had been brought there by unrestricted writ of error or appeal.
>
> * * * * * * *
>
> (c) No judgment or decree of a circuit court of appeals or of the Court of Appeals of the District of Columbia shall be subject to review by the Supreme Court otherwise than as provided in this section."

3. The case is a proceeding instituted originally before the United States Board of Tax Appeals by the Petitioner herein as an appeal from a determina-

tion of a deficiency in income and profits taxes for 1917 by the Commissioner of Internal Revenue, the Respondent herein. (R. 10-42; 45-51; 53-78.)

4. From a decision by the United States Board of Tax Appeals (R. 145-146) in favor of the Petitioner herein, the Commissioner of Internal Revenue, Respondent herein, filed his petition for review and assignments of error in the United States Circuit Court of Appeals for the Ninth Circuit (R. 146 et seq.), and that Court reversed the order of the United States Board of Tax Appeals. It is the judgment of the said Circuit Court of Appeals reversing the order of the said Board which the Petitioner herein desires to have reviewed.

5. The only question involved is whether or not certain income from oil produced and sold in 1916, and impounded in the hands of a receiver during that year and turned over to the Petitioner herein in 1917, is taxable income to the Petitioner in 1916, as held by the said Board of Tax Appeals, or in 1917, as held by the said United States Circuit Court of Appeals, or in some other year. The case arises under Sections 10 and 13 of the Revenue Act of 1916, 39 Stat. 756, c. 463, and Sections 4, 201 and 1206 of the Revenue Act of 1917, 40 Stat. 300, c. 63.

SUMMARY OF MATTER INVOLVED.

1. On July 15, 1913, the Petitioner herein acquired by purchase certain oil producing properties described as Section 2, Township 32 South, Range 23 East, M.

D. B. & M., Kern County, California. This section was included in the lands described in Temporary Petroleum Withdrawal No. 5,[1] which was issued by President Taft on September 27, 1909, and which was the cause of the litigation in the case of *U. S. v. Midwest Oil Co.*, 236 U. S. 459. Legal title to Section 2 was in the United States at the date of the withdrawal order, and no discovery of oil had been made. Subsequent to the date of the withdrawal order, and sometime prior to November 30, 1915, suit was begun by the United States against the Petitioner herein, and others, "to obtain a decree adjudging that the defendants thereto had no right or interest in a certain section of the then public land of the United States known and described as Section 2, Township 32 South, of Range 23 East of the Mt. Diablo Base and Meridian, or in any of the oil, gas, or other mineral contained therein, for the appointment of a receiver of the property, for an injunction, and an accounting of the oil that had been extracted from the land." (*U. S. v. North American Oil Consolidated et al.* (C. C. A. 9), 264 Fed. 336.) On February 3, 1916, the District Court of the United States, for the Southern District of California, Northern Division, appointed a receiver for the property "and of the oil, gas, and other property of every kind

1. Entitled "Temporary Petroleum Withdrawal No. 5," the text of this order was as follows:

"In aid of proposed legislation affecting the use and disposition of the petroleum deposits on the public domain, all public lands in the accompanying lists are hereby temporarily withdrawn from all forms of location, settlement, selection, filing, entry, or disposal under the mineral or nonmineral public-land laws. All locations or claims existing and valid on this date may proceed to entry in the usual manner after field investigation and examination."

The list attached to the order described lands which included Section 2, Township 32 S., Range 23 E., M. D. B. & M., Kern County, California. See *U. S. v. Midwest Oil Co.*, 236 U. S. 459, at p. 467.

now situated on the said land or already extracted therefrom * * *." The receiver was directed to operate the property and to collect all moneys from the sale of oil. He was permitted to allow the Petitioner herein to operate the property (R. 116-120), and at all times during the period of the receivership "said Section 2 was in the physical possession of and operated by" the Petitioner herein. (R. 163.) In addition to the said Section 2, the Petitioner herein was then operating other oil lands which were not involved in the said case of *United States v. North American Oil Consolidated, et al.,* supra, and which were not involved in the said receivership. (R. 93 et seq.)

2. During the period from February 2, 1916, to December 31, 1916, the receiver received and impounded net income from oil produced from Section 2 during that period in the amount of $171,979.22. (See Findings of Board of Tax Appeals, R. 123.)

The order appointing the receiver was vacated by the District Court on June 5, 1917 (R. 120, 121, 122), and at that time the receiver turned over to the Petitioner herein the net income earned from the said property during the period of the receivership in the year 1916, the District Court holding (242 Fed. at 724-725) that on September 27, 1909, the date of the above mentioned withdrawal order, the Petitioner Company's predecessor in interest "was an actual bona fide occupant and claimant of the property * * *, for the purpose of acquiring title under the mining laws," and that it was in diligent prosecution of work leading to discovery within the meaning of the Pickett Act. Thereupon the Government appealed (242 Fed. 723,

264 Fed. 336) and the suit was finally disposed of by the Supreme Court of the United States in its mandate of March 21, 1922, which directed the dismissal of the appeal, pursuant to stipulation. (For text of mandate see R. 121, 122.) Thus at the late date of March 21, 1922, the Petitioner Company for the first time became assured by Court decision that on and at all times subsequent to September 27, 1909 (the date of the withdrawal order), and even including the year 1916, it and its predecessors in interest were entitled to the possession of the said Section 2, as against the Government, and had the right to extract the oil and gas and to sell and derive income therefrom, although during the period of February 3, 1916-December 31, 1916 income from the said section had, on motion of the Government, been impounded in the hands of a receiver.

3. In the proceeding before the United States Board of Tax Appeals, the respondent herein stipulated **"That at all times during said receivership the income from oil produced on said Section 2 was entered on the books of the North American Oil Consolidated (the Petitioner herein) as its income."** (R. 163.)

4. The United States Board of Tax Appeals expressly found that, **"At all times during the receivership the income from the oil produced from Section 2 was entered on the books of the petitioner (North American Oil Consolidated) as its income.** The income from said Section 2 was not included in the petitioner's original return for 1916 which was filed in March, 1917, **but was included in its amended return**

for 1916, which was filed on March 27, 1918. By letter dated March 23, 1918, attached to the amended return, the respondent was fully advised as to all the facts regarding the litigation and receivership. A revenue agent made an examination of the petitioner's books in 1920." (R. 122-123.) (For text of letter see R. 173-175.)

5. In the proceeding before the United States Board of Tax Appeals the record shows that until sometime after the Petitioner herein had appealed to that Board, the Commissioner had not contended that the impounded funds were taxable to the Petitioner in 1917. The contention that they were taxable to the Petitioner herein in 1917 was first made by the Respondent Commissioner in 1927 in the form of an affirmative defense during the pendency of the proceeding before the Board. (R. 46-47, pars. (7), (8) and (9).)

In its opinion the Board of Tax Appeals states that "the respondent affirmatively alleges that the amount impounded in the hands of the receiver in 1916 and released to petitioner in 1917 was income to the petitioner in the latter year." (R. 139.)

6. The United States Board of Tax Appeals deeming it to be "immaterial whether petitioner's accounts were kept on the receipts and disbursements basis or some other basis as permitted by Section 13 (d) of the Revenue Act of 1916 (39 Stat. 771)," held that the receiver should have reported the impounded funds for taxation in 1916 and that his failure to do so was "no sufficient reason for taxing the petitioner on it in a later year." (R. 139-140; 50 F. (2d) 752, at p.

754, first col.) The Board made no express finding that the accounts of the Petitioner were kept on either the accrual or the cash basis unless the findings set out in paragraph 3 above can be said to be tantamount to a finding that the Petitioner's accounts were kept upon the accrual basis.

7. The United States Circuit Court of Appeals, in its ~~first~~ opinion (50 Fed. (2d) 752, at p. 755) decided (1) that "in view of the departmental construction placed upon the statute (Section 13, subdivision (c), Revenue Act of 1916, 39 Stat. 756, 771), which seems to be in accordance with the intent of Congress, the receiver was not required to make a return of this income (the impounded funds), but the respondent corporation (North American Oil Consolidated) was required to do so," and (2) that the impounded funds were properly taxable as income for the year when they were received by the Petitioner herein (the year 1917) regardless of whether or not the Petitioner's returns were made upon a cash or accrual basis. In this second opinion the said Circuit Court of Appeals corrected its first opinion in several particulars and then adhered to its original decision.

IMPORTANCE OF QUESTION PRESENTED AND REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

The decision of the Circuit Court of Appeals in the instant case stands for the grossly inequitable proposition that the Government itself may, with one hand, prevent income from reaching its real owner in the year in which it is produced and, with the other hand,

take a larger share of taxes than would be collectible otherwise, solely because the Government itself prevented the income from reaching the owner during the year in which it was produced. The consequences of this construction of the taxing statutes are obviously unjust and it is submitted that the language of the statutes does not compel that result.

This case is of great importance to the Petitioner and, as well, it is believed, to numerous other oil companies whose funds were, upon the application of the Government, impounded in the hands of a receiver during the period of years when the oil land withdrawal orders, beginning with the above mentioned withdrawal order of September 27, 1909, were causing litigation over the titles to oil properties in California, and were resulting in the impounding in a receiver's hands of the production from the properties, the titles to which were in litigation between the Government and the claimants.

The reasons relied on for the allowance of the writ are:

In reversing the order of the Board of Tax Appeals the learned Circuit Court of Appeals placed its decision on the grounds, first, that the receiver appointed in the case of *United States v. North American Oil Consolidated et al.,* supra, "was not required to make return of this income (the income impounded during the period February 3, 1916-December 31, 1916), but the respondent corporation (the Petitioner Company) was required to do so" (50 F. (2d) 755), because subdivision (c) of Section 13 of the Revenue Act of 1916, 39 Stat. 756, 771, providing for returns by receivers

where they are operating all, and not part of, "the property or business of corporations" (50 F. (2d) 754), although the litigation in which the receiver was appointed was between the Government and the Petitioner Company; and, secondly, irrespective of the basis of accounting employed by the Petitioner Company, and largely if not wholly upon the supposed authority of *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, that "the amount of this income was properly taxed as income for the year when it was received by" the Petitioner Company. (50 F. (2d) 755.)

1. The question here decided,—that a receiver in charge of only a part of the property of a corporation is not required to make a tax return under the provisions of Section 13 (c) of the Revenue Act of 1916—has not been passed upon by this Court, so far as Petitioner herein has been able to learn. The section itself, which is set out in the brief which follows this petition, contains no exception or limitation which would seem to warrant the construction placed upon it by the learned Circuit Court of Appeals, and the regulations relied on by the Circuit Court of Appeals find no support in either Section 13 (c) or subsequent acts.

2. The second ground of the decision of the learned Circuit Court of Appeals—that, whether on the accrual or the cash basis, the impounded funds were properly taxable to the Petitioner Company in 1917 because they were physically received by the Petitioner in that year, although the effect of the decisions in *United States v. North American Oil Consolidated, et al.*, supra, was that the Petitioner was at all times

entitled to the income—seems to be invalid for at least two reasons: (a) If the Petitioner was on the accrual basis of accounting the impounded funds were accrued as income in 1916, under the finding of the Board of Tax Appeals, and on plain principles were taxable to the Petitioner in that year; and (b) if the Petitioner was on the cash basis of accounting, its right to the impounded funds was not determined until 1922, and, it would seem, the funds were "impounded funds" at all times until March 21, 1922, although they were received by the Petitioner in 1917.

Wherefore, your Petitioner respectfully prays that a writ of certiorari may issue to the United States Circuit Court of Appeals for the Ninth Circuit commanding that Court to certify and send to this Court a full and complete transcript of the record of all proceedings of the said Court in the above entitled case, to the end that the said case may be reviewed and determined by this Court, as provided by law.

Dated, San Francisco, California,
December 9, 1931.

NORTH AMERICAN OIL CONSOLIDATED,
By HERBERT W. CLARK,
Its Attorney.

In the Supreme Court
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United States

OCTOBER TERM, 1931

No.

NORTH AMERICAN OIL CONSOLIDATED
(a corporation),
Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,
Respondent.

Petitioner's Brief.

JURISDICTION OF THE CASE.

This proceeding is brought, and this petition is filed, to review the decision of the United States Circuit Court of Appeals for the Ninth Circuit in the case of *David Burnet, Commissioner of Internal Revenue, Petitioner, v. North American Oil Consolidated, a corporation, Respondent.* The case was originally

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Unless otherwise indicated italics have been supplied.

decided by the said Circuit Court of Appeals on the 15th day of June, 1931, and Petitioner's petition for a rehearing in that Court was denied on the 15th day of September, 1931. The original opinion will be found at pages 184-193 of the transcript of record herein. The opinion rendered upon the petition for rehearing appears in 50 F. (2d) 752, and a copy thereof, together with a copy of the order denying the petition for a rehearing, appears in the transcript of record at pages 194-203.

The jurisdiction of this Court is invoked under subdivisions (a) and (c) of section 240, as amended, of the Judicial Code, U. S. C. A. title 28, section 347, which are set forth in the foregoing petition for writ of certiorari at pages 2 and 3.

STATEMENT OF THE CASE.

The parties are described and identified in the foregoing petition for writ of certiorari at page 2, and the nature of the proceedings is described therein at pages 2-4.

The facts of the case are briefly stated in the foregoing petition at pages 4 to 9; the proceedings before the United States Board of Tax Appeals and before the said Circuit Court of Appeals are set forth in the foregoing petition at pages 7 to 9; all with appropriate page references to the printed record herein.

SUMMARY OF ARGUMENT.

The impounded funds should have been reported by the receiver for taxation in 1916. If the impounded funds should not have been reported by the receiver for taxation in 1916, they were taxable to the Petitioner Company in that year because they constituted accrued income of the Company for that year.

On the other hand, if the impounded funds should not have been reported as income in 1916 by either the receiver or the Petitioner Company, then they should not have been reported at all prior to the year 1922, which was the year in which the litigation was finally terminated in favor of the Petitioner Company.

POINT ONE: THE IMPOUNDED FUNDS SHOULD HAVE BEEN REPORTED BY THE RECEIVER FOR TAXATION IN 1916.

The Petitioner herein submits that the learned Circuit Court of Appeals was wrong in holding that the receiver was not required to make return of the impounded funds for taxation in 1916.

Section 10 of the Revenue Act of 1916 (c. 463, 39 Stat. 756) reads as follows:

> "That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax of two per centum upon such income;

* * * * * * *

The foregoing tax rate shall apply to the total net income received by every taxable corporation, joint-stock company or association, or insurance company in the calendar year nineteen hundred and sixteen and in each year thereafter, * * *."

Section 13 (a) and (c) of the same Act, so far as pertinent, read as follows:

"(a) The tax shall be computed upon the net income, as thus ascertained, received within each preceding calendar year ending December thirty-first: * * *.

* * * * * * *

(c) In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control; * * *."

Section 4 of the Revenue Act of 1917 (c. 63, 40 Stat. 300) provides for the levying and collecting of an additional tax of four per centum "upon the income received in the calendar year 1917"; and section 10 (a) of the same Act provides for the levying and

collecting of an additional tax of two per centum of the net income "received in the preceding calendar year." (See Appendix A for complete text of pertinent portions of these sections.)

Regulations 33 (revised) were promulgated pursuant to section 1005 of the Revenue Act of 1916, supra. Articles 26 and 209 relate to receivers and, so far as they are pertinent to the question here involved, they are as follows:

"Art. 26.

* * * * * * *

Par. 181. Receivers who, as officers of a court, stand in the stead of some principal are required to account for income tax as the principal would have been required to account.

Art. 209. *Receivers to make returns.*—Section 13, paragraph C, of this title requires receivers, trustees in bankruptcy, or assignees, who are in charge of and are operating the property and business of corporations, to make returns of annual net income and pay any income tax thereby shown to be due, regardless of what disposition, subject to the orders of the court, may be made of such income.

Notwithstanding the fact that the powers and functions of the corporation are suspended and that the property and business are for the time in control and custody of the receiver, trustee, or assignee, subject to the orders of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required for the purpose of this title to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. The income which he receives on account

of the business transacted is the income of the corporation and, no matter how such income is applied, it is subject to the tax imposed by this title in so far as it exceeds the deductions or allowances authorized by law.

The receiver, trustee, or assignee acting for the corporation, is required to make a true and accurate return of annual net income covering each year or part of each year during which he is in custody and control of the business or properties and will be liable to all the penalties imposed by this title for failure to meet any of its requirements."

It is instantly observable that neither section 13(c) of the Revenue Act of 1916, supra, nor Article 209 of Regulations 33 (revised), supra, which interprets section 13 (c) of the statute, makes any exception in cases of receivers operating only part of the business of a corporation. The section of the statute unequivocally requires a receiver who is operating the property or business of a corporation to "make returns of net income as and for such" corporation. It is significant that the Revenue Act of 1918 changed the requirements as to receivers for **individuals**, but not **as to receivers for corporations**. Section 225 of the Revenue Act of 1918 (see Appendix B for text of section) provides that "every fiduciary (except receivers appointed by authority of law in possession of part only of the property of an **individual** shall make under oath a return for the individual, estate or trust for which he acts" in certain specified cases, but this exception does not even apply under the statute of 1918 if the receiver is in possession of part only

of the property of either an estate or a trust. Section 8 (c) is the corresponding section of the Act of 1916 (see Appendix C for text of section) and contains no exception in the case of receivers in possession of part only of the property of an individual. Section 239 of the Revenue Act of 1918 (see Appendix D for text of section) is substantially the same as section 13 (c) of the 1916 Act, and it makes no exception in the case of receivers in possession of part only of the property of a corporation.

Article 424 of Regulations 45 (see Appendix E), promulgated under the Revenue Act of 1918, contains the following sentence:

> "A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual **or corporation** need not."

The change in the Revenue Act of 1918 as to receivers for individuals evidently inspired this portion of Article 424, but the extension of the exception to receivers for corporations is not warranted by the statute.

Article 622 of Regulations 45 (see Appendix E) contains the following sentence:

> "A receiver in charge of only part of the property of a corporation, however, as a receiver in mortgage foreclosure proceedings involving **merely a small portion of its property,** need not make a return of income."

The Treasury Department apparently had in mind that if the receiver was in possession of "merely a

small portion" of the property of the corporation he should not be burdened with the necessity of making a return, and it is submitted that these sections of the statute should be so interpreted, and that Congress in reenacting section 225 and section 239 of the Revenue Act of 1918 in the subsequent revenue acts, so interpreted these articles of the regulations of the Department. If the regulations are not so interpreted they are not warranted by the language of the statute, particularly when the significant change in section 225 of the Revenue Act of 1918, as compared with section 8 (c) of the Revenue Act of 1916, is contrasted with the fact that no such change is contained in section 239 of the Revenue Act of 1918 as compared with section 13 (c) of the Revenue Act of 1916. It is clear that it is only in the case of **individuals** that a receiver who is in possession of only a part of the property need not render a return, and that such exception does not apply in the case of estates, trusts or corporations, with the possibility that the administrative policy expressed in the regulation, making an exception in the case of receivers holding "merely a small portion" of the property of a corporation, should be sustained.

In this connection the learned Circuit Court of Appeals said (50 F. (2d) 752, at p. 755) that if in the case of a receiver in charge of only a part of a corporation's property, the income impounded by the receiver from such parts of the corporation's property "is to be treated as a part of the income of the owner of the property, the amount of tax thereon would depend upon which one of the two litigants was subsequently determined to be the owner, and this difficulty

is particularly marked in the situation presented by the case at bar, where, if the income belonged to the government, it was not subject to tax, whereas, if it belonged to the respondent, the amount of tax thereon would depend upon the income derived by the respondent taxpayer."

This line of reasoning is, it seems to the Petitioner herein, equally applicable to the case of a receiver who is in possession of all the property of a corporation. Moreover, if the income had actually been held to belong to the Government no tax would have been collectible or payable anyway, whether the income had been derived from a part only or from all the property claimed by and operated by the corporation. In addition it is submitted that the facts in the case at bar are similar to the case of *Ferguson v. Forstmann,* 25 F. (2d) 47, affirming 17 F. (2d) 659. In that case the Alien Property Custodian in 1918 brought two suits against Mrs. Forstmann, who owned certain stock in Forstmann & Huffmann Company. The first was brought to compel her to surrender to the corporation certain shares of stock on the ground that they had been originally paid for by funds of the company. The Alien Property Custodian was a stockholder of the company by virtue of the seizure of some stock of that company owned by Germans. The second suit was brought to compel Mrs. Forstmann to surrender the balance of her shares on the ground that they were owned by alien enemies and as such had been seized by the Alien Property Custodian. While these suits were pending the Court entered an order restraining Mrs. Forstmann from transferring

any of her stock in the company and restraining the company from paying dividends to her. These suits were dismissed March 29, 1921, on motion of the Alien Property Custodian. While the company was under injunction dividends were declared on her stock in the sum of eighty-two thousand one hundred fifteen dollars ($82,115.00) on March 31, 1919, and one hundred thirteen thousand one hundred fifty dollars ($113,150.00) on February 28, 1920. When the suits were dismissed and the restraining orders vacated, these dividends were paid to Mrs. Forstmann. She did not include these dividends in her income tax returns for 1919 and 1920 because she had not received them when these returns were made. On March 15, 1922, she filed amended returns and included the eighty-two thousand one hundred fifteen dollars ($82,115.00) for 1919, and the one hundred thirteen thousand one hundred fifty dollars ($113,150.00) for 1920, and paid additional taxes for those years. Subsequently the Commissioner ruled that the dividends and interest were taxable income for the year 1921, when they were received by Mrs. Forstmann and assessed an additional tax for that year, which she paid under protest and then brought suit to recover; in the meantime Forstmann and Huffmann Company concluded that while the restraining order was in effect it was holding the dividends of Mrs. Forstmann's stock as a trustee or fiduciary, and that under the Revenue Act it was obliged to make a return and pay the tax due on such dividends.

The trial Court held that the dividends were income received and held in trust by the company as a

"fiduciary" for "unascertained persons" as provided in the Revenue Acts of 1918 and 1921. Two main issues were involved: First, whether or not the taxes could be legally assessed against and properly paid by the company as a fiduciary, and, second, whether or not if the taxes should have been assessed against Mrs. Forstmann and not the fiduciary they were assessable against her for 1919 and 1920, when declared, or for 1921 when received. The Circuit Court of Appeals for the Third Circuit reached the conclusion that the company as fiduciary should have paid the taxes upon such dividends during the years 1919 and 1920, and accordingly found it unnecessary to pass upon the second question.

In arriving at this conclusion the Court said:

> "(1). The order of the district Court directed that the dividends, declared and payable in 1919 and 1920, 'be held in the treasury of the company until the final determination in this suit of the true ownership of this stock.' Until this determination the dividends were allowed to accumulate and were held in trust for this 'unascertained' owner. Until then, the Forstmann & Huffmann Company was the trustee, conservator, or a person acting in a fiduciary capacity. While thus restrained from paying the dividends, the company was holding this property for the benefit of some person thereafter to be ascertained and was thus a trustee. Perry on Trusts and Trustees, vol. 1, Sec. 1. Whether or not such trust be express or implied is unimportant, for the statute includes both. It received and held these dividends in trust for some person whose identity was unascertained in 1919 and 1920. It

was thus a fiduciary, within the meaning of Article 1521 of the Regulations 45 and 62.

"(2). While the Forstmann & Huffmann Company was holding these dividends in obedience to the injunctive orders of the court, proceedings were being conducted to ascertain who was entitled to them, and during this time Mrs. Forstmann manifestly could not pay taxes on them. They were income accumulated for the benefit of some person, yet unascertained. The Government was entitled to receive the taxes for the years when the dividends were declared, but there was not one who could safely pay them, except this fiduciary company. It might have been negligent in making its returns, but that did not relieve it of its statutory duty, and it was 'better late than never.'

"The action in these cases is akin to an equitable garnishment or equitable trustee process under statute. Phoenix Insurance Co. v. Abbott, 127 Mass. 558; Pendleton v. Perkins, 49 Mo. 565; Westwater v. Ferguson, 22 Pa. County Ct. 582. The company holding the dividends was an equitable garnishee. Such a proceeding in form is an action at law, but in substance is an action in equity, to determine the ownership of property in dispute, and in some states is called a 'trustee process.' As the relation of debtor and creditor exists between the garnishee and his original debtor, so the relation of debtor and creditor existed between the company and Mrs. Forstmann, although another creditor stepped in and claimed the hitherto undisturbed right of the original creditor.

"The Alien Property Custodian, in bringing these suits and obtaining these injunctions, was

employing substantially equitable processes to establish his equitable rights, alleging that one block of the stock belonged to the company (of which he was a stockholder) because purchased with its money, and the other block, on being seized, belonged to him. Under the injunctive orders, the company was required to hold both of these until the rightful owner was ascertained.

"These proceedings were clothed with the characteristics of a trust within the provision of section 219 (a) of the Revenue Acts of 1918 and 1921. Accordingly, it seems to us that the dividends in question constitute income accumulated 'for the benefit of. * * * unascertained persons,' the tax on which it was the duty of the company as 'fiduciary' to pay."

While the Circuit Court in this case states that it is unnecessary to decide whether if the tax had been assessable against Mrs. Forstmann it should have been assessed in the years 1919 and 1920 instead of 1921, the effect of its decision is that the dividends in question were not taxable to Mrs. Forstmann in either of the three years. This is the necessary inference from the holding of the Court that the tax on the dividends should have been reported by the company as a fiduciary.

The reasoning of the Court in the *Forstmann* case is applicable to the case at bar. The income involved was earned and received in 1916. During that year its ownership was uncertain. A receiver had been appointed by the Court to collect and impound this money. The Petitioner would have received the money

in 1916 had it not been for the action of the Government in securing the appointment of this receiver. As the income was earned and received in 1916 the Government was clearly entitled to receive the tax in that year on this income. Under the statute as it then existed, the receiver was required to make the return of income for 1916 and pay the tax due. The record does not show whether or not the receiver made such a return. Whether he did or not he was legally liable to do so, and the fact that he may not have made a return, is, as the Board points out, not a sufficient reason for imposing a tax on the Petitioner in a different year. The record shows, however, that when Petitioner received from the receiver the moneys earned and received by him during 1916 it filed an amended return for 1916 in which it included this amount.

It is submitted on this phase of the matter that neither section 13 (c), nor any article of the regulations promulgated to carry it into effect, justifies the interpretation placed upon section 13 (c) of the Revenue Act of 1916 by the Circuit Court of Appeals.

POINT TWO: IF, HOWEVER, THE IMPOUNDED FUNDS SHOULD NOT HAVE BEEN REPORTED BY THE RECEIVER FOR TAXATION IN 1916, THEY WERE TAXABLE TO THE PETITIONER COMPANY IN THAT YEAR BECAUSE THEY CONSTITUTED ACCRUED INCOME OF THAT COMPANY FOR THAT YEAR.

The Petitioner has already pointed out in the petition for writ of certiorari that in the proceeding before the United States Board of Tax Appeals the Respondent Commissioner stipulated "That at all

times during said Receivership the income from oil produced on said section 2 was entered on the books of the North American Oil Consolidated as its income" (R. 163); and that the Board of Tax Appeals expressly stated in its opinion herein that the Petitioner Company "accrued in each year on its books the income applicable to the oil produced and sold." (R. 139.) It is also true that in 1917, in filing its tax return for 1916, the Petitioner did not include any part of the impounded funds, although they had been accrued upon its books of account. But in 1918 the Petitioner filed its amended return for 1916 and included all impounded funds as income for 1916, explaining the situation regarding the litigation and the receivership in a letter dated March 23, 1918, which was attached to the amended return. (R. 122-123.)

In its original opinion herein, the Circuit Court of Appeals stated that, "It is admitted that the taxpayer made its income tax returns upon the cash basis." (R. 190.) No such admission was made by the Petitioner Company at any time, and upon petition for rehearing, after its attention had been called to this inadvertency, the Circuit Court of Appeals eliminated from its opinion the sentence just quoted. Undoubtedly the sentence crept into the original opinion because of the fact that in compliance with the request contained in the Respondent Commissioner's form of tax return (R. 169) that the Petitioner Company "State whether or not this return is made upon the basis of actual receipts and disbursements"—the Petitioner Company replied "Yes," and made no response to the suggestion printed on the same form, "If not, describe

just what other basis or method was used in computing net income." But, as stated by the District Court for the Southern District of New York in the case of *Consolidated Tea Co. Inc. v. Bowers, Collector of Internal Revenue,* (1927) 19 F. (2d) 382, at p. 383:

> "The answers at the end of the return are merely informatory; they do not change the facts. At the most, they might be regarded as an intention by the one who prepared the report to have it on a cash basis."

But the Board of Tax Appeals made no finding that the accounts were kept or the returns made on the cash basis. The issue, as already stated, was affirmatively raised by the Respondent Commissioner after he had, in the 1917 sixty-day letter (see Transcript of Record at top of page 23), expressly made a readjustment of income for "taxes in excess of accrual." Inasmuch as the Commissioner had the affirmative of the issue that the impounded funds were taxable in the year 1917, it was incumbent upon him to prove all facts necessary to sustain his contention. One of such facts was that the Petitioner kept its accounts upon the cash basis and/or made its returns upon the cash basis. This burden of proof, to repeat, was upon the Commissioner. (*Appeal of General Lead Batteries Co.,* 2 B. T. A. at p. 395.) But the practically if not wholly undisputed facts indicated that the accounts of Petitioner were kept on the accrual basis and the Commissioner himself, as we have already pointed out, adjusted the 1917 tax return in respect of "taxes in excess of accrual."

The Board of Tax Appeals deemed the question of the basis of accounting and/or the basis of the re-

turn immaterial inasmuch as the decision went off on the question of the duty of the receiver to make return of the impounded funds for 1916 under the mandate of section 13 (c) of the Revenue Act of 1916.

It has been many times held by the Board of Tax Appeals that the present availability or nonavailability of income is immaterial because present beneficial use is not a test of the accrual of income.

See:

Appeal of Illinois Terminal Co., 5 B. T. A. 15;
Appeal of Cincinnati, Findlay & Ft. Wayne Railway Co., 5 B. T. A. 108;
Appeal of New Orleans, Texas and Mexico Railway Co., 6 B. T. A. 436;
Virginia Carolina Sec. Corpn. v. Commissioner of Internal Revenue, 6 B. T. A. 84;
Appeal of S. W. Harris, 2 B. T. A. 933;
Appeal of Mead Construction Co., 3 B. T. A. 438;
Appeal of Walter Cravens, 3 B. T. A. 282.

The real test of accrual seems to be, not availability for beneficial use, but the right of the taxpayer to the income. And in the case at bar it was decided by the federal Courts (*United States v. North American Oil Consolidated, et al.*, supra) that the Petitioner Company had at all times a right to the income in question. That was a necessary resulting incident of the decisions mentioned. And it has been held that the existence of a dispute over the ownership of or right to income does not operate to postpone its accrual. Thus in the case of *Ferguson v. Forstmann,*

supra, it was remarked that the Government's position was tantamount to taxing as Congress had authorized, and by its deferring payments, taking "a larger share than would have been possible but for" the activities of the Alien Property Custodian. The Court said:

> "* * * With one hand it deprived the plaintiff of her income, and with the other it levied a larger tax, when it permitted her to take her income, than could have been levied if the government had not stopped its receipt."

That is precisely what has happened in the case at bar.

It is submitted that the decisions of the federal Courts in the case of *United States v. North American Oil Consolidated, et al.,* supra, necessarily mean that the Petitioner Company herein at all times during 1916 had a legal right to the income produced from the property and impounded in the hands of the receiver. This legal right was a necessary incident to the Petitioner Company's right to Section 2 itself. And this being so it would seem necessarily to follow that, inasmuch as the income from the impounded funds was accrued upon the books of the Petitioner Company as its income in 1916, the impounded funds were taxable to the company in 1916, if they were not reportable by and taxable against the receiver in that year.

POINT THREE: BUT IF THE IMPOUNDED FUNDS SHOULD NOT HAVE BEEN REPORTED AS INCOME IN 1916 BY EITHER THE RECEIVER OR THE PETITIONER COMPANY, THEN THEY SHOULD NOT HAVE BEEN REPORTED AT ALL PRIOR TO THE YEAR 1922, WHICH WAS THE YEAR IN WHICH THE LITIGATION WAS FINALLY TERMINATED IN FAVOR OF THE PETITIONER COMPANY.

The case of *Consolidated Tea Company Inc. v. Bowers,* 19 F. (2d) 382 (District Court, New York, 1927), is directly in point on the proposition that the impounded funds cannot constitute income in 1917, but were reportable as income either in 1916 or 1922. Although that case dealt with the time for deducting an obligation which was the subject of litigation, nevertheless the principle is the same as the determination of the time for reporting income which is the subject of litigation. The facts were that prior to 1919 the Tea Company was sued for certain commissions which it was claimed it had failed to pay, and in 1919 a judgment was rendered against the Tea Company for approximately $10,000. The Tea Company set up a reserve in the amount of the judgment and charged the amount to profit and loss. It deducted the amount of the judgment on its income tax return for the year 1919. In January, 1921, the judgment was affirmed by the Appellate Court and paid by the plaintiff. The Court holds that the income tax returns of the Tea Company were made on the accrual basis, although on the returns it was stated that they were made on the basis of actual receipts and disbursements. In holding that even though the returns were rendered on the accrual basis, nevertheless the amount of the judgment could not be deducted until 1921, when the litigation was finally terminated, the Court said:

"It seems to me that *the time of the mere rendering of a judgment is not the controlling* factor in determining when a loss is sustained. It has no particular significance in this case. From all that appears in the record the services may have been rendered or the damage occurred upon which the judgment was founded prior to 1919; in fact, it was conceded upon the argument of the motion to dismiss that *the action against the Tea Company had been pending for some two years* before it was reached for trial in 1919, and further it does not appear that the claim in the action against the Tea Company was an unliquidated one.

"*From a tax income standpoint, both logical and practical, reasons seem to me to support the conclusion that a loss should be deductible not in the year when the judgment was rendered but in the year when the claim was adjudicated to be final and definite, or possibly, under certain circumstances, in the year when the claim originated.*

* * * * * * *

"The plaintiff, the Consolidated Tea Co., Inc., sued to recover a portion of the tax it was compelled to pay for the year 1919, and it bases this right to a refund on the ground that the amount of the judgment rendered against it in 1919 was a proper deduction for that year, and *while it is not necessary in deciding this case, and is probably inadvisable with the present record to determine whether the loss in question may have been deductible at the time the services were rendered or the damage occurred upon which the judgment against the Tea Company was founded, or was deductible when the judgment was affirmed and paid, I think it is clear that it*

was not deductible in 1919, and accordingly a verdict is directed in favor of the defendant."

The following decisions support the position that a judgment is not deductible in the year in which it is entered in the lower Court where an appeal is taken, but should be deducted upon the final termination of the litigation:

Farmers Nat'l. Bank of Rome v. Commissioner, 6 B. T. A. 1036;

Jewell v. Commissioner, 6 B. T. A. 1040;

Lehigh & Hudson River Ry. v. Commissioner, 13 B. T. A. 1154; affirmed by Circuit Court of Appeals in 36 F. (2d) 719, as modified by 38 F. (2d) 1015; certiorari denied May 5, 1930.

The learned Circuit Court of Appeals apparently placed great reliance upon the decision of *Burnet v. Sanford & Brooks Co.,* 282 U. S. 359. But that case is, it is submitted, clearly distinguishable from the case at bar. In that case the Sanford & Brooks Co. was engaged during the years 1913, 1914 and 1915 in dredging the Delaware River for the Government at a certain contract price. In December, 1915, the company ceased work and subsequently brought suit against the United States, such suit being based on a breach of warrant of the character of the material to be dredged. Judgment was recovered for the actual loss sustained by the company, being the difference between the payments received under the contract and the amount expended by the company in performance of the contract, such judgment being eventually affirmed by the Supreme Court in 1920. It is obvious

that the recovery of this judgment did not represent money "which should have been paid in the prior years," or "money due during the years of performance of the contract," as contended by the Respondent Commissioner. Sanford & Brooks Co. claimed that the amount recovered was a reimbursement of losses sustained in prior years and was, therefore, not income. They maintained that they broke even on their dredging operations and, therefore, they could not have realized income therefrom; and they proposed to file amended returns for the years 1913, 1915 and 1916, eliminating the dredging loss taken in those years (the operations in 1914 having resulted in a profit). The theory was that there was no loss in those years and no income in 1920. The Supreme Court refused to accept this theory, holding that income must be returned on the basis of fixed accounting periods. The Supreme Court also stated that an exception exists in the case of the regulations relating to long term contracts which permit the reporting of profit or loss at the termination of the work, but stated that the taxpayer had not availed itself of these provisions. It is, therefore, clear that there is no parallel whatever between the *Sanford & Brooks* case and the instant case. Sanford & Brooks Co. did not even contend that the amount recovered constituted income in the years in which dredging operations were carried on, probably for the reason that they realized that the recovery was in the nature of damages and that the amount to be recovered was uncertain until fixed by the Court. By no possibility, therefore, could this amount be construed to be income in any year prior to its recovery. It is true that

Sanford & Brooks attempted to obtain the same result, but only by maintaining that no income whatever was realized, and that, therefore, the amount recovered should not be reported in 1920, since it was not income.

CONCLUSION.

It is respectfully submitted that a writ of certiorari should issue as prayed for in the petition herein.

Dated, San Francisco, California,
December 9, 1931.

HERBERT W. CLARK,
Attorney for Petitioner.

(Appendices A, B, C, D and E Follow.)

Appendices.

Appendix A

PERTINENT PARTS OF REVENUE ACT OF 1917, C. 63, 40 STAT. 300.

Sec. 4. That in addition to the tax imposed by subdivision (a) of section ten of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, there shall be levied, assessed, collected, and paid a like tax of four per centum upon the income received in the calendar year nineteen hundred and seventeen and every calendar year thereafter, by every corporation, joint-stock company or association, or insurance company, subject to the tax imposed by that subdivision of that section, * * *.

Sec. 201. That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereinafter in this title referred to as the tax) equal to the following percentages of the net income: * * *

Sec. 1206. (1) That the first paragraph of section ten of such Act of September eighth, nineteen hundred and sixteen, is hereby amended to read as follows:

Sec. 10. (a) That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized, but not including partnerships, a tax of two per centum upon such income; * * *.

Appendix B

SECTION 225, REVENUE ACT OF 1918.

That every fiduciary (except receivers appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for the individual, estate or trust for which he acts (1) if the net income of such individual is $1,000 or over if single or if married and not living with husband or wife, or $2,000 or over if married and living with husband or wife, or (2) if the net income of such estate or trust is $1,000 or over or if any beneficiary of such estate or trust is a non-resident alien, stating specifically the items of the gross income and the deductions and credits allowed by this title. Under such regulations as the Commissioner with the approval of the Secretary may prescribe, a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of such individual, estate or trust to enable him to make the return, and that the same, is, to the best of his knowledge and belief, true and correct.

Fiduciaries required to make returns under this Act shall be subject to all the provisions of this Act which apply to individuals.

Appendix C

SECTION 8(c), REVENUE ACT OF 1916.

Guardians, trustees, executors, administrators, receivers, conservators, and all persons, corporations, or associations acting in any fiduciary capacity, shall make and render a return of the income of the person, trust, or estate for whom or which they act, and be subject to all the provisions of this title which apply to individuals. Such fiduciary shall make oath that he has sufficient knowledge of the affairs of such person, trust, or estate to enable him to make such return and that the same is, to the best of his knowledge and belief, true and correct, and be subject to all the provisions of this title which apply to individuals: *Provided,* That a return made by one of two or more joint fiduciaries filed in the district where such fiduciary resides, under such regulations as the Secretary of the Treasury may prescribe, shall be a sufficient compliance with the requirements of this paragraph.

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SECTION 225, REVENUE ACT OF 1918.

That every fiduciary (except receivers appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for the individual, estate or trust for which he acts (1) if the net income of such individual is $1,000 or over if single or if married and not living with husband or wife, or $2,000 or over if married and living with husband or wife, or (2) if the net income of such estate or trust is $1,000 or over or if any beneficiary of such estate or trust is a non-resident alien, stating specifically the items of the gross income and the deductions and credits allowed by this title. Under such regulations as the Commissioner with the approval of the Secretary may prescribe, a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of such individual, estate or trust to enable him to make the return, and that the same, is, to the best of his knowledge and belief, true and correct.

Fiduciaries required to make returns under this Act shall be subject to all the provisions of this Act which apply to individuals.

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Guardians, trustees, executors, administrators, receivers, conservators, and all persons, corporations, or associations acting in any fiduciary capacity, shall make and render a return of the income of the person, trust, or estate for whom or which they act, and be subject to all the provisions of this title which apply to individuals. Such fiduciary shall make oath that he has sufficient knowledge of the affairs of such person, trust, or estate to enable him to make such return and that the same is, to the best of his knowledge and belief, true and correct, and be subject to all the provisions of this title which apply to individuals: *Provided*, That a return made by one of two or more joint fiduciaries filed in the district where such fiduciary resides, under such regulations as the Secretary of the Treasury may prescribe, shall be a sufficient compliance with the requirements of this paragraph.

Appendix D

SECTION 239, REVENUE ACT OF 1918.

That every corporation subject to taxation under this title and every personal service corporation shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice-president, or other principal officer and by the treasurer or assistant treasurer. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent.

In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

Returns made under this section shall be subject to the provisions of sections 226 and 228. When return is made under section 226 the credit provided in subdivision (c) of section 236 shall be reduced to an amount which bears the same ratio to the full credit therein provided as the number of months in the period for which such return is made bears to twelve months.

Appendix E

REGULATIONS 45, ARTICLES 424, 622.

Art. 424. *Return by receiver.* A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. If the receiver acts for an individual the return shall be on form 1040 (revised) or 1040A (revised). When acting for a corporation a receiver is not treated as a fiduciary, and in such a case the return shall be be made as if by the corporation itself. See section 239 of the statute and article 622. A receiver in charge of the business of a partnership shall render a return on form 1065 (revised). A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common-law receivers of all the property or business of an individual or corporation must make returns. See also section 256 of the statute and articles 1071-1080.

Art. 622. *Returns by receivers.* Receivers trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations on form 1120, covering each year or part of a year during which they are in control. Notwithstanding

that the powers and functions of a corporation are suspended and that the property and business are for the time being in the custody of the receiver, trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. A receiver in charge of only part of the property of a corporation, however, as a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income. See articles 424 and 547.